BEFORE THE PUBLIC SERVICE COMMISSION

OF SOUTH CAROLINA

Joint Application and Petition of South Carolina Electric & Gas Company and Dominion Energy, Inc. for review and approval of a proposed business combination between SCANA Corporation and Dominion Energy, Inc., as may be required, and for a prudency determination regarding the abandonment of the V.C. Summer Units 2 & 3 Project and associated merger benefits and cost recovery plans

Docket Nos. 2017-207-E; 2017-305-E; 2017-370-E

Surrebuttal Testimony of **Scott J. Rubin**

on Behalf of
AARP

October 29, 2018

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Q. Please state your name.

A. My name is Scott J. Rubin. I previously submitted direct testimony on behalf of AARP in this proceeding.

Q. What is the purpose of your surrebuttal testimony?

A. I will briefly respond to some of the criticisms of my testimony made by witnesses for South Carolina Electric & Gas Co. ("SCE&G" or "Company"). In particular, I will discuss some of the statements made in the rebuttal testimonies of Company witnesses Lapson, Young, and Hubbard.

Q. Have you reviewed the rebuttal testimony of Ellen Lapson filed on October 24?

A. Yes, I have reviewed the portion of the testimony that responds to my testimony.

Q. On page 38 of her rebuttal testimony, Ms. Lapson claims that your recommendation is "radical," that it would be "extremely punitive" to SCE&G, and that your interest is to "inflict[] pain on shareholders of SCANA." How do you respond?

A. Respectfully, I would suggest that it is not helpful for Ms. Lapson to use of this type of hyperbole with no factual support. As I explained in my direct testimony, my proposal is premised on a fair sharing between consumers and shareholders of the consequences of management's decision to pour more than $5 billion into a failed construction project. Consumers have received absolutely no benefit from this expenditure and had no control over the decisions made by management to continue pursuing this project.

I explained in my testimony that there were numerous signs in 2013 and early 2014 that the project was destined for failure and should be terminated. Moreover, I made my recommendations without the benefit of the testimony from ORS witnesses

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who focused on SCE&G management's inexplicable delays in hiring an independent consultant (Bechtel) to provide an assessment of the cost and schedule; the Company's attempts to alter Bechtel's findings to suit management's purposes; and management's decisions to withhold this critically important information from the Commission, ORS, and SCANA shareholders.

Contrary to Ms. Lapson's assertions, I have no interest in "inflicting pain" on shareholders. My goal is to provide a path forward for the Company to get out of the mess that management created. If shareholders feel "pain" as a result, that harm is the result of management's decisions, including its continuing failure to recognize reality and disclose the true state of the project schedule and cost estimates.

Q. Ms. Lapson suggests on pages 38 and 39 that your recommendation of a $2 billion after-tax write-down in common equity would have "grave consequences." Do you agree?

A. I do not find any support for Ms. Lapson's assertions of "grave consequences" for SCE&G's ability to continue to finance its business. At year-end 2017, SCANA had a common equity ratio (common equity divided by total capitalization) of 47.1%.[1] According to the Edison Electric Institute ("EEI"), the regulated electric utility industry had an equity ratio at year-end 2017 of 42.3%.[2] Thus, according to the EEI report, SCANA already had an equity ratio that was about five percentage points higher than was typical for the electric utility industry, and that was after the $1 billion write-off was

[1] Exhibit SJR-13 (filed with my direct testimony), p. 8.

[2] Edison Electric Institute, 2017 Financial Review Annual Report of the U.S. Investor-Owned Electric Utility Industry, p. 12, available at: http://www.eei.org/resourcesandmedia/industrydataanalysis/industryfinancialanalysis/finreview/Pages/default.aspx

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taken. Under my recommendation, SCANA's equity ratio would be about seven percentage points lower than is typical for the industry. In other words, SCANA would go from having an equity ratio about 12% above the industry average to having one that is about 17% below the industry average. I'm not suggesting that investors would love this result – nor should they; there is no question that the actions of Company management have harmed the Company's financial health – but such a result would not be catastrophic.

Q. Ms. Lapson claims that under your proposal SCE&G would "most likely" have bond ratings below investment grade. How do you respond?

A. I do not know how rating agencies would react if SCE&G put this matter behind it, took a significant write-off, perhaps further reduced its common stock dividend, trimmed the ranks of management, stopped spending money on litigation, and took other actions to normalize Company operations. Even if that resulted in a bond rating below investment grade for a period of time, however, it would not mean that SCE&G would be unable to raise capital. Currently, it is very common for telecommunications utilities to have bond ratings below investment grade. From my experience working on several merger cases in that industry, I believe only Verizon and AT&T still have investment-grade bond ratings, but they all manage to raise significant amounts of capital to continue providing customers with safe and reliable service.

In summary, neither Ms. Lapson nor anyone else has provided any information showing that my recommendations would result in SCE&G being unable to raise capital when needed to ensure the provision of safe and reliable service to its customers.

Q. Have you reviewed the rebuttal testimony of Kyle Young?

A. Yes.

Q. On pages 4 and 5, Mr. Young states that you do not "recognize that there were numerous mitigation actions undertaken by the Consortium, at the Owner's request, that helped to improve upon fabrication, delivery, assembly, installation and construction for the CA20 module for Unit 2 as well as other major structural and mechanical modules for the Project." Is he correct?

A. While I did not mention them in my testimony, I was aware of many of these actions from my review of the Santee Cooper public documents. I am also aware that many of these actions were taken after there already had been lengthy delays and failures of performance by the contractors. It also is unclear whether these actions led to any improvement in the timeliness and quality of performance. For example, one of the most significant changes was to allow the contractor to assemble and repair portions of the CA20 module on-site, rather than shipping completed components. That occurred in September 2013,[3] but it seemed to have little effect on timely completion of the module, which suffered numerous delays after that time, as I described in my direct testimony.

In other words, I did not ignore the changes that were made. I based my recommendation on the totality of circumstances that existed in 2013 and early 2014 and found that any reasonable and prudent utility would have cancelled the project at that time.

[3] Exhibit SJR-1 (filed with my direct testimony), p. 7.

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Q. Have you reviewed the rebuttal testimony of Glenn Hubbard?

A. Yes, I reviewed the portion of Dr. Hubbard's testimony that responded to my direct testimony.

Q. On pages 8 through 12 of Dr. Hubbard's rebuttal testimony, he discusses the U.S. Supreme Court's decision in *Duquesne Light Co. v. Barasch* and how that decision might affect the outcome of this case. Do you agree with Dr. Hubbard's discussion and conclusions?

A. I do not agree with Dr. Hubbard's conclusion that an "economic analysis" of the court's decision would result in even greater cost recovery for SCE&G than it has requested. Dr. Hubbard relies primarily on an article published in 1991 by Kolbe and Tye. Drs. Kolbe and Tye were two of the founders and principals of the Brattle Group which was, and continues to be, a major consulting firm representing utility companies. It is neither surprising nor particularly informative that utility-industry consultants sought to use the court's decision to justify higher rates of return.

More importantly, neither the article by Kolbe and Tye nor Dr. Hubbard's testimony provide any evidence that market-based determinations of the cost of capital are insensitive to the potential for disallowance of prudent investments that never become used and useful. The U.S. Court of Appeals for the D.C. Circuit addressed this point directly in a 2003 case reviewing a rate of return finding by the Federal Communications Commission ("FCC"), stating:

> Ameritech contends that the rate of return does not adjust for the disallowance of prudent investments. See *Williston Basin Interstate Pipeline Co. v. FERC*, 289 U.S. App. D.C. 310, 931 F.2d 948, 954 n.6 (D.C. Cir. 1991). There is always the risk that the "used and useful" rule

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> will exclude part of the original investment from the rate base. The FCC held that because investors are aware of its rate base policies, the agency's market-based methodologies for determining the rate of return will produce a rate high enough to compensate for that risk. 1990 Rate Represcription, 5 FCC Rcd at 7521, P 120. Whether a DCF rate does compensate for the risk of disallowance has been questioned. See A. Kolbe & W. Tye, The Fair Allowed Rate of Return with Regulatory Risk, 1992 RES. L. & ECON. 129, 142-50; S. Williams, Fixing the Rate of Return After Duquesne, 8 Yale J. On Reg. 159, 160 (1991). But Ameritech has failed to provide sufficient evidence or argument to convince us that the DCF rate does not compensate for such risk.[4]

That is, even if there were some increase in the cost of capital due to the potential risk for disallowance of prudent investments, that risk already would be reflected in a discounted cash flow analysis of utility-industry peers. Thus, there is no "extra regulatory risk" (Hubbard rebuttal, p. 19) for which SCE&G and its investors need to be compensated. They already have received a market-based return on their investment, and that market-based return included the risk of disallowance.

Q. On page 13 of his testimony, Dr. Hubbard disagrees with you that traditional regulation requires a utility investment to be both prudent and used and useful. Can you clarify this issue?

A. Yes. When I wrote in my direct testimony that traditional regulation required utility investments to be both prudent and used and useful, I was being specific to utility regulation in South Carolina prior to the enactment of the Base Load Review Act ("BLRA"). Dr. Hubbard is correct that some jurisdictions do not require both tests to be met, but that is irrelevant to this case. What matters here is the regulatory regime in South Carolina before (and now after) the BLRA. I rely specifically on a 2005 decision of this Commission which quoted from a South Carolina Supreme Court decision

[4] *Ill. Bell Tel. Co. v. FCC*, 300 U.S. App. D.C. 296, ___, 988 F.2d 1254, 1263 (1993) (emphases added).

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defining rate base as "the amount of investment on which a regulated public utility is entitled to an opportunity to earn a fair and reasonable return; and represents the total investment in, or the fair value of, the used and useful property which it necessarily devotes to rendering the regulated services."[5] Related discussion in that 2005 decision makes clear that the prudency of an investment also was evaluated.

Interestingly, that decision found that where an investment was prudent when made but never became used and useful, SCE&G could recover the amount of its investment through an amortization, but could not earn any return on the investment.

Q. If that same standard were applied to this case, what would be the result?

A. It is apparent from the testimonies submitted by various parties that there is a dispute about how much of SCE&G's investment was prudent. In my testimony, I show that the project should have been cancelled during 2013 or, at the latest, by mid-2014. The plant investment at year-end 2013 was approximately $2.3 billion. By mid-year 2014, the investment had grown to approximately $2.5 billion. SCE&G already has collected approximately $2.2 billion in rates for this project that will never be used and useful. This provides further support for my recommendation that SCE&G is not entitled to recover any additional revenues from customers, and certainly not the billions of dollars more that it would recover under the Company's proposals.

[5] *Application of South Carolina Electric & Gas Company for Adjustments in the Company's Electric Rate Schedules and Tariffs*, 2005 S.C. PUC LEXIS 1, *118-119, 238 PUR4th 369 (2005), citing *Hamm v. Public Svc. Comm'n*, 422 S.E. 2d 110, 112 (S.C.1992).

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Q. On page 23 of his rebuttal, Dr. Hubbard quotes from the BLRA. Does his quoted language support his point that SCE&G is entitled to full recovery of its investment?

A. No, it does not. The section quoted by Dr. Hubbard states that costs must be prudently incurred.[6] The statute defines prudence as based on "the information available at the time that the utility could have acted to avoid or minimize the costs." This is the same standard I used in my testimony where I found that SCE&G was imprudent for failing to cancel the project in 2013, or by mid-2014 at the latest.

Q. On page 30 of Dr. Hubbard's rebuttal testimony, he performs calculations showing the increased cost of capital based on the changes in the BLRA. Is he correct?

A. No, he is not correct. First, as I discussed above, if market-based proxies were used in setting SCE&G's cost of capital, then the cost of capital already included the risk of disallowance. Second, the methodology Dr. Hubbard uses assumes that all of SCE&G's remaining investment ($4.2 billion) was funded by common equity. This is not correct. In fact, the Company issued billions of dollars in new debt to fund construction of the project.

Dr. Hubbard also makes a further unsupported assumption on page 31. There he explains the results of an analysis based on the theory that "markets for the securities of publicly traded companies are informationally efficient and, therefore, the prices of these securities reflect all material, publicly available information." There is a fundamental flaw with that approach to this case because SCE&G never publicly disclosed material

[6] I am advised by counsel that the correct cite is S.C. Code Ann. § 58-33-280(K).

information about the cost escalations and schedule changes that its consultant (Bechtel) determined were realistic.

In fact, SCE&G never even disclosed that it had retained a consultant to conduct that analysis, and never explained why it dragged its feet for more than a year between deciding such a review was needed and actually conducting it. These facts would have been extremely important to investors, but SCE&G never disclosed them. Thus, any conclusions Dr. Hubbard may attempt to draw from investor actions based on publicly available information are seriously flawed – investors never had the information they needed to accurately assess the actions of management or the impact of those actions on investors.

Q. On page 33, Dr. Hubbard explains that SCANA's stock price fell by 39% after the abandonment announcement, costing equity investors $3.4 billion in market value. Is that important to the Commission's determinations in this case?

A. No, I do not believe this fact is particularly important to the issues before this Commission. The fact that the stock price fell could be a direct result of SCANA finally telling investors the truth about the project. Had investors known the real costs and schedule of the project in 2013, 2014, or 2015, then the stock price probably would have been depressed much earlier. If, as the ORS and Environmental Parties' witnesses contend, SCE&G failed to disclose material information to the Commission and investors, then of course the stock price fell when that material information was made public. That does not provide any useful information about who should bear the costs of the project going forward.

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Indeed, exactly the same point could be made about SCE&G's customers. Had they (meaning the Commission and ORS, as well as other parties) been given material information about the project in 2013, 2014, or 2015, rates would not have been increased in 2015, saving ratepayers hundreds of millions of dollars. Dr. Hubbard does not seem to consider the consumers' side of the equation at all in his testimony or analysis.

Q. In conclusion, does the testimony of any of the Company witnesses change any of the recommendations or conclusions in your direct testimony?

A. No.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

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